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Supreme Court, U.S.
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NO._____

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

RICHARD R. SYLVESTER AND IRENE L. SYLVESTER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondant

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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April 12, 1991

QUESTIONS PRESENTED

1. Does a trial court *violate fundamental standards of fairness* to decide a complex case with an oral opinion, with no opening statement, no closing argument, no briefs, and no time for the court to review the content of business records in evidence?

2. Does a trial court abuse its discretion to assert *lack of credibility based on a disputed interpretation of law*, when there is adequate disclosure of facts, accurate description of facts, and no false statement of fact?

3. Does a trial court abuse its discretion to disallow tax credit carryover from *closed tax years* and disallow dependant care tax credit, contrary to statute?

4. Does a trial court abuse its discretion to *exclude evidence of bad faith by the Commissioner* which would act to negate the presumption of correctness and shift the burden of presenting evidence?

LIST OF PARTIES

The parties are listed in full on the title page, Rule 24.1(b). There is no parent or subsidiary company to list pursuant to Rule 29.1.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The petitioners Richard R. and Irene L. Sylvester respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled proceeding on January 14, 1991.

OPINIONS BELOW

The memorandum opinion of the Court of Appeals for the Ninth Circuit has not been reported. It is reprinted in the appendix hereto.

The memorandum opinion of the U.S. Tax Court has not been reported. It is reprinted in the appendix hereto.

JURISDICTION

Invoking federal subject matter jurisdiction under 26 U.S.C. 6212, 6214 and 7442, the petitioner brought this suit in the U.S. Tax Court. The U.S. Tax Court entered an Order and Decision on July 14, 1989.

On petitioner's appeal, with jurisdiction under 26 U.S.C. 7482(a), the Ninth Circuit on January 14, 1991 entered a judgment and opinion affirming in part and remanding in part. This petition is filed within the 90 day limit, Rules 13.1 and 30.1.

The jurisdiction of the Supreme Court to review the judgment of the Ninth Circuit is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES

Pertinent portions of the following are included in the Appendix.

U.S. Constitution, Amendment I and V

17 U.S.C. 410(c)

26 U.S.C. 21 (formerly sec. 44)

26 U.S.C. 38

26 U.S.C. 41 (formerly sec. 44F)

26 U.S.C. 162

26 U.S.C. 174, 183, 212, 213

26 U.S.C. 262

26 U.S.C. 274

26 U.S.C. 280A

26 U.S.C., 1001, 1011, 1012, 1016

26 U.S.C. 1311, 1312

26 U.S.C. 6214, 6501

26 U.S.C. 6653(b)

26 U.S.C. 6661(b)(2)(B)

26 U.S.C. 7430(a)(2)

P.L. 99-44

STATEMENT OF THE CASE

Issues. The fundamental constitutional issues are whether the trial court procedure so far departed from fundamental principles of accepted trial procedure that the taxpayer was denied *procedural due process*, and whether the actions of the Commissioner to suppress the taxpayers publishing business violate *freedom of expression*, U.S. Constitution, Amend. I and V.

The disputed statutory issues are deductibility of expenses under 26 U.S.C 162, disallowance of research credit carryforward from closed tax years, dependant care credit, and computation errors under Tax Court Rule 155.

Summary of Facts and Circumstances. This case involves the redetermination of deficiency in income tax for the tax year 1983. The primary area of dispute is the amount of costs allowed as business deductions. The dispute involved mixed issues of fact and law.

The petitioner has operated a sole proprietorship business for over two decades, specializing in business consulting and publishing of books, casettes, and software. Both husband and wife are active in business operations. Both husband and wife have advanced degrees and many years of professional experience in quantitative methods, appropriate for computer software development. The husband is listed in *Who's Who in Finance and Industry* and *Who's Who in the World*. The wife is listed in Marquis *Who's Who of American Women* and Jane's *Who's Who in Aerospace*. Computer software is part of the product line for the publishing operation, which includes books and cassette tapes. The taxpayer developed computer software during 1983, as evidenced by the Certificates of Copyright Registration.

The publishing operations had substantial sales for many years, with nationwide advertising in Library Journal, Scientific American, New Yorker, Wall Street Journal Barrens and Investor's Daily. Software and books published by the taxpayers are listed in national

directories, such as Bowker's *Software Encyclopedia* and Bowker's *Books in Print*. The business purpose of the expenses is demonstrated by resulting substantial Schedule C revenue, ranging from $166,678 in 1980, to $3,632 in 1983, and $29,131 in 1985. Sale of a copyright in 1979 resulted in an installment sale for $1.4 million.

Most of the costs were substantiated with detailed receipts and cancelled checks, and documents that described the business circumstances, such as samples of advertising and publications. Some of the costs for software development were substantiated through reconstruction of costs, without specific receipts. Over 1000 pages of descriptions of circumstances, work product, and purchase receipts were admitted into evidence to substantiate and corroborate the taxpayer's deductions.

The trial court gave an oral decision, without closing argument and without briefs, disallowing all taxpayer deductions not stipulated by the Commissioner, stating

that the taxpayer failed to carry his burden of proof and citing lack of taxpayer credibility. The Ninth Circuit upheld the trial court's decision, except for one item of calculation under Rule 155.

Issues of Dispute

Office at Home Expense. The amount of cost was stipulated. The allocation between business and personal use was disputed. In addition to the sole proprietorship business operations, the taxpayer was employed by General Dynamics and Northrop Corporation during 1983. It was stipulated that 155 boxes of research materials were stored at the taxpayer's residence and the employers did not have sufficient space in taxpayer's office for storage of the research documentation. (Stipulation 38,40). Exhibits showed that substantial space was used for storage of *inventory* for the publishing business, which is *not subject to the requirement for exclusive use*, 26 U.S.C. 280A(c)(2).

A listing of contents of the Northrop Library on December 31, 1983 was offered into evidence as taxpayer's business records, with offer of proof that the evidence would establish that Northrop did not possess required research documents. The offer of proof showed that the evidence established that employer Northrop did not possess documents necessary for employee assignments. *The court declined to admit the exhibit into evidence.*

Testimony by the General Dynamics manager supported the taxpayer's position, indicating that storage and use of materials by an employee *would be helpful to the employer.*

It was stipulated that 39.47% of the residence space was used for the claimed activities; the Commissioner claimed the activities were non-deductible personal activities (Stipulation 46). The office at home expenses were disallowed on the basis of non-exclusive use. The primary reason cited was several book titles, comprising less than 5% of the library, which were held to be

personal in nature. A critical issue is whether this small amount of personal use was *de minimus*, as a matter of law, and therefore did not prevent exclusive use.

Investment Tax Credit. Taxpayers claimed investment tax credit for the following investments during 1983:

Cost	Tax Credit
Auto, 1972 Mercedes, 85% use	$681.14
Office equipment, table	100.27
Master tape, computer software	1,171.45
Total	$1,952.86

The Commissioner admitted that $295 tax credit was earned during 1983 (Stipulation 29, 90 day letter 9a). *This $290 tax credit was not included in the Rule 155 computation, in error.*

For auto expense, the Commissioner stipulated $7,374 as costs for auto use, but allowed only $725 as business expense (Stipulation 25,28). The taxpayer submitted detailed tabulations of mileage, by origin and

destination, with documentation of details and business purpose of sample trips.

The taxpayer capitalized $11,714.48 as costs for a master tape for computer software, with depreciation over 5 years, and $1089.28 deducted. The Commissioner admitted that $5,805 was paid but *disallowed all costs*, as without a profit motive under 26 U.S.C 183 and not ordinary and necessary under 26 U.S.C. 162 (Stipulation 57, 58). The costs were:

Books, periodicals	$31.36
Travel, air fare, hotels	3,143.42
Business equipment	328.61
Business convergence	3,386.50
Supplies, research	2,257.63
Supplies, development	2,566.96
TOTAL	$11,714.48

The taxpayer asserts that substantial costs are implied due to the work product, the copyrighted software. Evidence submitted included the copyright registrations, advertising for the software, reviews of the

software by software distributors, and documentation of sales of the software.

The trip to Amana, Iowa cost $823.23 for four days, with a stated business purpose of selection of a supplier for a custom conference table, made in Amana, Iowa. This statement was supported by receipts for the purchase of the table. The Commissioner allowed the cost of the table as a capital business expense (Stipulation 64). However, the Commissioner disallowed all of the travel costs as a personal expense. The taxpayer visited a relative in Iowa during the trip. It is no evidence on the record that the personal visit was a primary purpose of the trip.

The trip to Rome, Italy cost $2,311.19, and the taxpayer was outside the U.S. for seven days (Stipulation 66). Thus, higher standards for deducibility do not apply; the standards are the same as for routine domestic travel, 26 U.S.C. 274(c)(2)(A).

A listing of specific firms observed in Rome was submitted into evidence to substantiate the business

purpose of market research. Prior publications with photographs taken by the taxpayer were admitted into evidence to substantiate the secondary purpose of obtaining photos for publications. The photos were put in the file of photographs to be used in future publications (Transcript p. 90). However, photos taken during this trip were not used. *The trial judge did not allow requested opportunity for explanation of the exhibits*, including reasons why other photos taken by the taxpayer were used in later publications. Explanation would have shown that the trip costs were reasonable because the taxpayer has previously paid $250 per photo for reproduction rights to photographs for his publications. Instead, a premature oral opinion cut off opportunity for explanation. (Transcript pp. 40, 55, 118).

Taxpayer showed evidence of $4,855.95 for costs of software research supplies. Evidence shown to substantiate the costs included the software source code and the copyright registration certificate. The Commissioner disallowed all costs for software

development, claiming the costs were not ordinary and necessary.

Business Travel and Quiet Business Meals. The Commissioner admitted to $1,716 for travel costs and $3,343 for quiet business meals (Stipulation 57). The court allowed *zero*, asserting *none* of the business travel and business meal cost was ordinary and necessary, 26 U.S.C. 162.

The trial court and Ninth Circuit are clearly in error as to facts and law. The requirement for at least some business meals are implied by the circumstances, including increased revenue in later years resulting from current year marketing effort and tangible results of research effort. Business meetings during a meal are a typical and ordinary business practice.

Under the quiet business meal exception, section 274 substantiation is not required because the meal is assumed to be deductible, 26 CFR 1.274-2(f)(1).

Supper money furnished by an employer to an employee working overtime is deductible, 26 CFR 1.274-2(b)(1)(i). By definition, the self-employed taxpayer is considered as both employer and employee, 26 U.S.C. 401(c)(1)(A). Under applicable regulations, meals for a business purpose are deductible, because the business purpose takes precedence over the personal benefit.

Dependent Care Tax Credit. The issue was whether medical and hospital care expenses outside of the residence qualify for dependent care credit (Stipulation 78). Taxpayer wife was temporarily disabled for 77 days during 1983, with $1,007.13 for medical treatment and care. The hospital receipts submitted into evidence (Exhibit 51) show that wife was in the hospital for 9 days during 1983 for surgery for a broken leg, with general anaesthesia, which is generally known to result in a temporary unconscious and helpless state.

The medical costs for wife are counted only as a dependant care expense, and are not deducted under 26

U.S.C. 213 (Stipulation 82). During 1983, Wife ordinarily and regularly did reside at the joint residence of the Petitioners, for at least 8 hours per day (Stipulation 83). Total dependant care costs were:

Care for child	$4,554.00
Care for wife	1,007.13
Total, dependant care costs	$5,561.13

The trial court allowed $480 credit for child and *zero for wife*. The trial court held that medical costs were limited by 26 U.S.C. 213.

The appeals court upheld the trial court, finding:

"There is no evidence on the record that Mrs. Sylvester was physically or mentally incapable of caring for herself ... The deducibility of medical expenses is governed (and limited) by section 213." Ninth Circuit Memorandum, III (H).

The decisions of the trial court and the Ninth Circuit are contrary to the clear evidence and the law. The exhibits and stipulations clearly show the wife was hospitalized under physician orders, which is prima facie

evidence of being incapable of self care. It is uncontroverted that wife was unconscious during surgery due to general anaesthesia and was therefore incapable of self care. Contrary to the Ninth Circuit opinion, Section 21 costs are expressly excluded under section 213(e).

> "Any expense allowed as a credit under section 21 shall not be treated as an expense paid for medical care." 26 U.S.C 213(e).

Bad Faith by the Commissioner. Bad faith by the Commissioner is highly relevant because of the impact on the presumption of correctness. Evidence of bad faith by the Commissioner included deceptive removal of critical pages from the agreed joint exhibits which documented the business purpose of specific meals (Transcript p. 47, lines 18-22).

Carefully documented evidence of bad faith was *excluded from evidence, in error* (Transcript, p. 52-54). This evidence demonstrated that the intent of the

Commissioner was to harass, annoy, oppress the taxpayer as *retaliation* for reporting to higher authority the improper request by the I.R.S. agent for over $1000 in merchandise without compensation and to discourage and suppress the publishing business, which specialized in tax law.

Bad faith by the Commissioner, with intent to annoy, harass, and suppress is shown by the results of prior litigation. It does not appear to be a coincidence that the Commisioner's litigation began with publications and public appearances on tax law by the taxpayer in 1976, and continued through the present in an evident attempt to suppress freedom of expression through imposition of substantial costs and time required to defend multiple year returns. Internal IRS memorandum obtained through the Freedom of Information Act clearly shows that the taxpayer was labeled as a "tax protestor." (Exhibit 52, excluded from evidence in error).

The following is a summary of other *Sylvester vs. Commissioner* cases in the U.S. Tax Court. The data

shows that the taxpayer substantially prevailed on the total amount in dispute for these cases.

	IRS Claim	Decision
1973, Docket 2707-77	$2,467	$2,172
1974, Docket 3889-78	$981	$45
1975, Docket 3274-79	$1,780	$349
1984, Docket 9997-88	$16,832	$2,970
1985, Docket 12373-89	$9,882	$3,765
Total	$31,942	$9,301

The evidence of bad faith by the Commissioner demonstrates that the position of the Commissioner was not substantially justified.

REASONS FOR GRANTING THE WRIT

I. The decision below has sanctioned a substantial departure from the accepted and usual course of judicial proceedings so that an exercise of the power of supervision is required to prevent denial of procedural due process.

The trial procedure was fundamentally unfair, due to lack of opportunity for explanation of exhibits. The time allocated for taxpayer's direct testimony was de minimus, covering 2 pages of a 123 page transcript. Over 1000 pages of business records were admitted into evidence but were ignored by the trial court. Specific exhibits were not admitted into evidence, over taxpayer's objection. Through premature announcement of oral opinion, the court effectively denied taxpayer's request to explain each exhibit.

There were no opening statements, minimal time allowed for petitioner testimony, no summary legal

arguments, and no trial briefs. There was no finding of facts and conclusions of law for each of the 34 issues, with particularity. Many hours would be reasonably required to review the exhibits. However, the court ignored the exhibits and expressed an oral opinion before sufficient lapse of time to allow even a brief court review of the exhibits admitted into evidence.

Trial procedure is reviewed for an abuse of discretion with prejudice required for reversal, *Kisor v. Johns-Manville Corp.* 783 F.2d 1337, 1340 (9th Cir. 1986). U.S. Tax Court decisions are reviewed on the same basis as civil bench trials in U.S. District Court, *Mayors v. C.I.R.*, 785 F.2d 757, 759 (9th Cir. 1986).

Premature Decision

The trial court failed to clearly state findings of fact for each of the 24 primary issues. The claimed lack of credibility of the taxpayer is erroneous, because it was not based on a diligent and patient review of all of the evidence. The oral opinion was premature, before all of

the exhibits were reviewed and discussed. The following statement by the trial judge claims diligence:

> "...I had a whole lot of documenation prior to the trial and I reviewed it, considered it carefully and I listened to the testimony, and it seems to me that this is a factual case, and that the facts are clear under the law." (Transcript, p. 118).

However, the oral opinion (Transcript pp. 119-122) does not state a clear finding of facts and does not correctly apply the facts to the law. The wording of the opinion demonstrates that the court was unaware of most of the exhibits admitted into evidence and was even unaware of the detailed content of the stipulations.

Credibility would be relevant only to whether the direct testimony was believed. However, in this case, the direct testimony merely summarized the content of the exhibits. Due to the complexity of fact and law, the findings of fact for this case must be from observations and inferences based on the *exhibits* admitted into evidence. By all appearances, the court failed to

diligently review the exhibits, because the conclusions are contrary to the evidence.

Most of the issues stated in the stipulation were not covered with particularity in the opinion. The motion for summary judgment was denied with no written opinion to demonstrate that the exhibits were patiently and diligently considered.

> "A judge should perform the duties of his office impartially and diligently....a judge should be patient ... a judge should accord ... full right to be heard ... a judge should devote adequate time to his duties...," ABA Code of Judicial Conduct, Cannon 3, (3), (4) and (5).

Statutory Interpretation. Statutes providing for taxation are to be construed strictly as against the taxing power in favor of the taxpayers, *Vaughan v. Warner*, 157 F.2d 26. Congress passed statutory provisions designed to: "...encourage the expansion of many small business activities..." and "... provide tax incentives for certain

investments to promote continued economic growth..." *General Explanation 1981 Act*, p. 27, *General Explanation 1984 Act.*, p. 5.

Credibility. The trial court upheld all of the Commissioner's disallowances, citing lack of taxpayer credibility. The court stated "Petitioner has presented a series of non-persuasive, exaggerated and incredible claims that constituted deductible expenses." Transcript p. 119-120). "Overall, Petitioner's testimony is inherently improbable and cynical, and we are not required to and do not accept it as true." (Transcript, p. 121).

However, the transcript and exhibits show no false statements by the taxpayer and only two pages of direct testimony (Transcript p. 44-46).

The trial court's criteria for judging credibility is suspect. The judge described the taxpayer's testimony as *uncorroborated* (Transcript p. 119), but there was corroboration with over 1000 pages of business records, primarily receipts prepared by independent third parties.

The taxpayers testimony was described as "improbable and cynical," (Transcript p. 121). *Probable* is defined as "... having the appearance of truth ... appearing to be founded in reason or experience ... supported by evidence which inclines the mind to believe, but leaves some room for doubt ...." Black's Law Dictionary, Fifth Edition, p. 1081. Thus, whether testimony is probable or improbable is a conclusion, based on observation of other evidence. By definition, testimony is not inherently improbable; the testimony must be compared to objective reality. In this case, the objective reality is described by over 1000 pages of business records, which supported the testimony.

Probative value is associated with relevance and admissibility, not with final weighing of the evidence. By definition:

> " 'Relevant Evidence' means evidence having any tendency to make the existence of any fact ... more probable ... than it would be without the evidence."

Fed.R.Evid. 401. "All relevant evidence is admissible...." Fed.R.Evid. 402.

The alleged quality of being *cynical* is not commonly understood to be related to lack of truthful, accurate description. Cynical is defined as "... given to faultfinding ... exhibiting feelings ranging from distrustful doubt to contemptuous ... disbelief..." Webster's Third International Dictionary, p. 566. To the contrary, a person with a discerning, critical attitude would be commonly understood to have increased credibility.

By contrast, testimony of an opposing witness was shown to be false. Portions of the testimony for the Commissioner by the manager from Northrop Corporation was clearly demonstrated to be false (Transcript p. 27, line 24). However, the trial court concluded the false statement did not affect the manager's credibility (Transcript p. 28, line 13).

The tax return, the petition, and the exhibits show evidence and statutory authority which could have been accepted by the court. The taxpayer requested

opportunity to explain detailed reasons for each deduction (Transcript, p. 40), but the court declined to allow direct testimony to explain the deductions (Transcript p.55). Accordingly, the cross-examination was outside of the scope of the direct (Transcript pp.56-82). The oral decision was given *without* a full and complete hearing of the facts and without sufficient time to explain detailed reasons for the deductions (Transcript p.119).

It is fundamental that a finding of incredible testimony must be based on *facts* such as inconsistent prior statements, false statements during trial, inaccurate descriptions of facts, reputation for untruthfulness, conviction of a crime involving false statements, or other objective standards. For this trial, there was no clear adherence to an objective standard to determine credibility. Instead, the claim of lack of credibility is used as an excuse for lack of diligence in determining the facts and the law for each issue.

The trial court's inferences from undisputed facts shall not be set aside unless clearly erroneous, because the inferences are assumed to be based on "experience with the mainsprings of human conduct" or "from the trial judge's experience with human affairs" , *United States v. One Twin Engine Beach Airplane,* 533 F2d 1106, 1108, *Lundgren v. Freeman,* 307 F2d 104, 115 (9th Cir, 1961). However, in this case, the court's inferences are based on disputed facts, on clearly erroneous findings, and on an incorrect legal standard. Therefore, the trial court's decision is subject to review de novo, *Apple Computer Inc. v. Formula International*, 725 F2d 521, 523 (9th Cir 1984), *Miss Universe, Inc. v. Flesher*, 605 F2d 1130, 1133 (9th Cir 1979), Fed.R.Civ.P 52(a).

In error of logic, *through circular reasoning,* the court used disallowance of claimed deductions as evidence of incredibility (Transcript, p. 119-121). Inherently, deducibility is a mixed question of fact and law. To dispute questions of law does *not* imply incredibility or even unethical stance. A lawyer may:

"...advance such claim or defense if it can be supported by good faith argument for an extension, modification, or reversal of existing law," Model Code of Professional Responsibility, DR 7-102(A)(2).

Deductions disallowed by the Commissioner are not evidence of lack of credibility.:

"The credibility of a witness may be attacked ... by evidence in the form of opinion or reputation ... but ... may refer only to character for truthfulness or untruthfulness ... specific instances of the conduct of a witness, for the purpose of attacking or supporting the witness' credibility, other than conviction of crime ... may not be proved by extrinsic evidence." Fed.R.Evid. 608.

The court used deductions conceded as evidence of negligence, Transcript p. 122. However:

" Evidence of ... accepting a valuable consideration in compromising ... a claim which was disputed ... is

The stipulations included exchange consideration in terms of mutual compromise on several issues. Thus, the compromised claims are inadmissible to prove invalidity and therefore negligence.

In the subject case, the taxpayers' testimony was substantiated by uncontradicted revenue and amounts spent. The rapid increase in revenue for later years was uncontradicted. The software copyrights are prima facie evidence and uncontradicted. Thus, the business purpose of the expenses claimed is corroborated by the circumstances.

The taxpayer was prevented from introducing character evidence of credibility, because character was not attacked until during the oral decision (Transcript, p. 121).

> "...evidence of truthful character is admissible only after the character of the witness for truthfulness has been attacked ..." Fed.R.Evid. 608(a)(2)

Ample evidence of truthful character could have been introduced, if the attack on credibility was prior to the

decision. The professional experience and academic background of the taxpayers were stipulated: "Tne education and experience background of the petitioners are stated as follows ... Husband: Marquis' *Who's Who in Finance and Industry* ... Wife: Jane's *Who's Who in Aerospace*." (Stipulation 7). The taxpayer's reputation for expertise, credibility and truthfulness is demonstrated by his qualification on many occasions as an *expert witness* in U.S. Federal Court and California Superior Court (Exhibits 15-0 at p. 263, 19-S, 20-T). If the character attacks were prior to the decision, the taxpayer would have had opportunity to show character evidence. The taxpayer could have shown that his testimony has been found to be fully credible so that his client prevailed at trial on every occasion in which his expert opinion report was admitted into evidence. Similarly, the taxpayer could have shown that the taxpayer was selected by attorneys in over 350 cases to be an expert witness at trial (Exhibit 15-0 at p. 263). Also, the taxpayer could have shown that his testimony was accepted as credible by

(Exhibit 15-0 at p. 263). Also, the taxpayer could have shown that his testimony was accepted as credible by seasoned federal judges when he testified as a party and not as an expert, *Sylvester v. Commissioner*, T.C. Memo, 1978-461, Judge Sterrett, *Financial Collection Agencies et al. vs. Sylvester*, U.S. Bankruptcy Court, No. LA 81-000089 (CA), 1981. Judge C. Ashland. Also, the taxpayer could have directed the attention of the court to exhibits that were prima facie evidence of reputation for high credibility, such as sharing the speaker's rostrum at a national symposium with former President Ford (e.g, Exhibit 15-O, p. 263).

Therefore, the court's conclusion regarding lack of taxpayer credibility was contrary to the evidence, was based on incorrect procedure, and was in conflict with standards for determining the truth as stated in the Federal Rules of Evidence. The prior court decisions in which the taxpayer was accepted as a trusted and reliable witness establish taxpayer credibility by collateral estoppel.

II. The Ninth Circuit decision conflicts with decisions of this court and other Circuits.

Determination of ordinary and necessary. The tax court disallowed many costs as not ordinary and necessary business expenses, with a strained interpretation of the statute, 26 U.S.C. 162. Ordinary and necessary business expenses are deductible, *26 U.S.C. 162.* "Necessary" is defined as *appropriate and helpful*, even if not essential, not causally related or not prudent, *Welch v. Helvering 290 US 111.*

Necessary is defined as *appropriate and helpful*, even if not essential, not related to business activities by proximate cause or not prudent. The judgment of the taxpayer is given primary weight with regard to whether an expense is appropriate: "... we should be slow to override his judgment." *Welch v. Helvering* 290 U.S. 111 at 113, *Surasky v. U.S.*, 325 F.2d 191.

The trial court's finding of zero deductions for meals, travel, or research supplies is clearly *unreasonable,* in view of the substantial business activity, substantiated by the copyrighted software.

Credibility. The taxpayer provided extensive documentation substantiating the claimed deductions. Prior case law states the court must accept as true, and base its decision on, the unrebutted testimony of a taxpayer where there is no reason to disbelieve him, *Herbert v. Riddell*, 103 F. Supp 369; *Davis v. Nicholas* 204 F2d 200; *M&W Gear Co. vs. Comm.*, 446 F2d 841, revg & remg (1970) 54 TC 385.

The uncontradicted, unimpeached, competent and relevant testimony of the taxpayer cannot be disregarded by the Tax Court; such testimony overcomes the presumption that the IRS' determination is correct, *Roth Office Equipment Co. v. Gallagher* (1949, CA6) 172 F.2d 452; *A&A Tool Supply Co. v. Comm.*, 182 F.2d 300; *Farnsworth & Co., Inc. v. Comm.*, 203 F.2d 490; *Robinson*

Truck Lines, Inc. vs. Comm., 183 F.2d 739. For the subject case, the taxpayer's testimony was not shown to be false and was not directly contradicted as to an observable fact by any other witness.

For the Court to choose not to believe the taxpayer, the IRS must discredit the testimony of the taxpayer by cross-examination or the taxpayer's testimony must be found to be incredible, *Oswald Co., Inc. v. Comm.* (1950, CA 7) 185 F2d 6, cert. den. 340 US 943; *Burford Toothaker Tractor Co. v. Comm.* (1951, CA 5) 192 F2d 633, cert. den 343 US 941. For the subject case, the court's finding of incredibility was contrary to the content of the stipulations and exhibits.

Burden of proof. The taxpayer effectively shifted the burden of submitting evidence by establishing a prima facie case, through admission into evidence of business records with corroboration by business circumstances. The Commissioner has the burden of proof for new matters raised by the Commissioner after the IRS

answers the petition, TC Rule 142(a), *Preseley Sr.*, TC Memo 1979-359;, where a deficiency determination is arbitrary and unreasonable, *Vesco* TC Memo 1979-369, *Good Chevrolet*, TC Memo 1977-291, *Stafford, Jr.* TC Memo 1983-650; for an increase in deficiencies over the amount allowed in the notice of deficiency, *Goldstein*, TC Memo 1975-355; or a new theory where different evidence is required from the former theory, *Est. Schott*, TC Memo 1982-222, *Baird v. Comm.*, 438 F2d. 490, vacg. and remg. TC Memo 1969-67; or where the taxpayer submits sufficient evidence to negate the IRS' presumption of correctness, *Herbert v. Comm.* (1966 CA 9) 377 F.2d 65, revg TC Memo 1964-223.

Initially, the burden of proof is on the petitioner, TC Rule 142(a). When the petitioner introduces credible and competent evidence tending to prove that the deficiency is wrong; the presumption of correctness for the Commissioner's deficiency is overcome, *New York Life Ins. Co. vs. Gamer*, 303 U.S. 161, *Griffin v. Commissioner*, 285 F.2d 91. For a deficiency that is

arbitrary and unreasonable, the Commissioner has the burden of proof, *Rickey v. Comm*, 7/19/74, CA-9, Affg. 54 TC 680. Upon submission of supporting evidence, the taxpayer does establish a prima facie case that the deductions are correct, so that the burden of proof is on the Commissioner to rebut the evidence.

Error. There is adequate evidence of clear error. Essential factual inquiries and the findings of historical fact are reviewed under the clearly erroneous standard; the lower court's findings are rejected if the appellate court is left with the definite and firm conviction that a mistake has been committed, *U.S. vs. U.S. Gypsum Co.*, 333 U.S. 364, 395 (1948). The trial judge's findings of fact shall not be set aside unless clearly erroneous, Fed. R. Civ. P. 52(a), *Cooling Systems and Flexibles, Inc. v. Stuart Radiator, Inc.*, 777 F.2d 485, 487 (9th Cir. 1985).

Personal Character or Type. The tax court disallowed most of the expenses because the items had a personal

character or appearance. *However, the purpose of the expense is primary, not the type or character of the expense;* costs with a *business purpose* are business costs, not personal expenses, *Hill v. Commissioner, 181 F.2d 906.* Travel expenses for wife are deductible where presence of wife served a business purpose, *U.S. v. Walt Disney*, 413 F2d 783 (1969), *Duncan v. Bookwater*, 216 F.Supp. 301. In this case, wife had appropriate business education and experience to serve useful business purposes.

Unless otherwise expressly provided, no deduction is allowed for personal expenses, *26 U.S.C. 262.* However, an asset purchased and used for a *business purpose* is not a personal expense. The deducibility is controlled by function and use, not by type or appearance. The purpose is of primary importance. The type or character of the expense is not relevant; costs with a *business purpose* are business costs, not personal expenses, *Hill v. Commissioner, 181 F.2d 906.*

The taxpayer provided evidence that meets the standard of "clear and convincing," including detailed

receipts, detailed calculations, and corroborating circumstances. The trial court disallowed the expenses based on *appearance of personal use*, contrary to the evidence of business purpose.

The court cited several examples of "personal" items to prove lack of credibility. However, the exhibits adequately disclosed the facts with legal authority for allocation as a deduction. Uncontroverted evidence showed that the Rolex watch was used as a demonstrator for advertising purposes, resulting in later purchases by clients (Motion for Summary Judgment, Exhibit 2, Transcript p. 117). There was *clear disclosure* of the sale of certain personal items (bicycle, power tools, etc.) which followed a long-term holding period to wait for price increase with inflation. The items were never claimed as used for business. The items arguably qualified for capital loss treatment under statutory exception, 26 U.S.C. 165(c)(2), (Tax Return p. 20).

These items were stipulated as not deductible, in compromise, and are therefore *not admissible* as evidence

of negligence or lack of credibility, Fed.R.Evid 408. However, adequate disclosure and supporting case law prevent a 25% negligence penalty, 26 U.S.C. 6661(b)(2)(B).

Maintenance costs for the residence in 1979 included a lawnmower, vacuum cleaner bags, and a lawn edger. (Transcript 62, 63). The items were included as part of the capital cost of the residence, instead of being expensed in one year as maintenance costs. Under statute, capital costs of the residence are deductible as depreciation *to the extent of proportionate business use*, 26 U.S.C. 280A. *It is not required that the specific component of residence cost have a business use.* There is broad discretion in the allocation of total costs, " ...Any ... method which is reasonable under the circumstances will be acceptable," CB 1962-2, p. 54. Also, by statute, absent double counting, the depreciation basis established in a closed tax year cannot be changed in an open tax year, 26 U.S.C. 1311, 1312.

Thus, the court erroneously classified items as "personal" due to type, rather than diligently reviewing the function, use, and applicable statutes. Approaching the limit on existing law does not impute incredibility:

> "... the very meaning of a line in the law is that you intentionally may go as close to it as you can if you do not pass it ... It is a matter of proximity and degree as to which minds will differ ..." *Superior Oil Co. v. Mississippi*, 280 U.S. 390, 395-96 (1930).

Over and over again the courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. *Commissioner v. Newman*, 159 F2d. 848, 851 (2nd Cir, 1947).

The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them, by means with the law permits, cannot be doubted. *Gregory v. Helvering*, 293 U.S. 465, 469.

III. The decision below raises important and unresolved questions of federal law.

The issue of standards for income tax deductions is a question of *high national importance.* Tax law interpretation is of primary importance to many business firms. For this case, the interpretation of law and the procedure used would place expected business deductions in jeopardy for many firms, resulting from confusion regarding judicial standards. Although the decisions were not officially published, there is *wide publication* of the "unpublished" decisions through various tax information services. Accordingly, the incorrect interpretation of statutes has potentially significant national impact.

Violation of fundamental standards of fairness. The trial procedure violated due process, Constitution, Amendment V, Fed.R.Civ.P. 43(a) 52(a), Fed.R. Evid. 611(a). The premature oral decision prevented

explanation of reasons for deducibility and presentation of supporting legal arguments, and thereby *prevented a fair trial.* An oral opinion, *without opening argument, closing arguments, or briefs*, is inappropriate for a case with many complex issues of mixed fact and law. The trial court failed to state separate findings of fact and conclusions of law, with particularity, for each of the 24 primary issues .

Credibility. The trial court's finding that the taxpayer lacks credibility is clearly erroneous, due to incorrect trial procedure. The trial court's conclusion is not based on false statements of fact, incomplete disclosure, or disreputable character. Instead, the trial judge asserted personal use, based on appearance. The trial judge used examples of taxpayer's claimed deductions as evidence of lack of credibility. However, the deducibility was primarily based on disputed interpretation of law, not on disputed facts. Thus, the court's conclusion of lack of

credibility was derived erroneously, through logical error of circular reasoning.

Clear errors in findings of fact. The decision is *contrary to the facts* established by stipulation, operation of law, exhibits, and circumstances. The Commissioner's calculations under Tax Court Rule 155 were clearly erroneous and were partially corrected by the Ninth Circuit only for one item.

Interpretation and application of the law concerning burden of proof and standard of substantiation. The copyright law shifts the burden of proof to the Commissioner for facts stated in the copyright certificate and for costs implied by the existence of the copyright. The taxpayer shifted the burden to produce evidence by introducing business records that were corroborated by circumstances. The registered copyright certificates provided prima facie evidence of the facts stated on the certificates, 17 U.S.C. 410(c). By inference, reasonable

and necessary costs to develop and produce the copyrighted works are established prima facie.

Presumption of correctness. The evidence of bad faith by the Commissioner acts to negate the presumption of correctness. The admitted intent of the Commissioner to suppress the publishing operation by influencing the contents of books published by the taxpayer, and through undue burden and harassment, violates the Constitution, First Amendment.

Standard of substantiation. Taxpayers met the Tax Court standard of "clear and convincing" evidence by submitting detailed business records into evidence, supported with corroborating circumstances. The taxpayers qualify for reimbursement of administrative costs for trial and Ninth Circuit Appeal because taxpayers prevailed on the most significant issue and on the majority of the significant issues, 26 U.S.C. 7430. For this case, the most significant issue was whether the

Schedule C operation had a profit motive; the Commissioner failed to prevail on this new issue, Tax Court Rule 142(a).

Auto mileage substantiation. Congress has clearly stated that contemporaneous mileage logs shall *not* be required to substantiate auto use, *1985-2 CB p.361.* In this case, the taxpayer provided extensive documentation on auto mileage, with rejection on the basis of "credibility" by the court. This court's position effectively negates the expressed intent to Congress to simplify auto mileage substantiation.

> "...the Treasury is *specifically prohibited* from requiring that taxpayers keep daily contemporaneous logs of their use of automobiles. Taxpayers are *not required* to maintain trip-by-trip logs and records encompassing each element of the substantiation standards of section 274(d) to justify a deduction or credit...", , emphasis added, *1985-2 CB p.361.*

Contemporaneous records are *not* required, *PL 99-44, sec. 1.* Regulations authorize substantiation of business use by calculation of total distances less detailed calculation of periodic personal use, *1985-2 CB pp. 94, 102.* Specific substantiation requirements of 26 U.S.C. 274(d) do not apply to local transportation costs before 12/31/85. After 12/31/85, are local transportation costs must be substantiated in the same manner as travel away from home , *1985-2 CB 351, 360, 363.*

Business expense substantiation. The court decision ignores business records as reliable evidence for the amount and implied purpose of business costs. The decision is contrary to existing law. Under existing law, the taxpayer may substantiate concurrent or repetitions expenditures or uses as a single item. Expenses may be aggregated; expenses may be prorated based on total business use. *1985-2 CB p.95.* Documentary evidence will not be required if not readily available; for business travel, documentary evidence is required only for lodging

or for other expenditures over $25, *1985-2 CB p. 103.* The more stringent substantiation requirements imposed by the 1984 Act do *not* apply for the 1983 return, *1985-2 CB p. 101.*

The tax court *disallowed all* of the expenses for software research. Evidence that a substantial amount was necessarily spent is shown by the uncontradicted business circumstances, including copyright registrations and tangible copies of software developed. It is settled law that approximation of expenses is sufficient substantiation, *Cohan v. Commissioner*, 39 F.2d 540 (2nd Cir. 1930), at 543-544; *Ellery W. Newton*, 57 TC 245 (1971). Business costs may be substantiated by estimates and inferred by circumstances, receipts are not required.

Specific substantiation is required for travel away from home, entertainment, and business gifts, *26 U.S.C. 274.* These substantiation requirements are *not* required for a quiet business meal, appropriate for business discussion, because a quiet business meal is not

considered entertainment, *26 CFR 1.274-2 (f)(2)(i).* Under the regulations, the substantiation requirements of *26 U.S.C. 274* do not apply to the disputed expenses.

Office at Home, Proportionate Use. The issue is whether *exclusive use does not consider de minimus personal use.* The parties stipulated that 7.2% of the office space was used for software development and consulting (Stipulation 36(c). However, the trial court held that no area was used exclusively, citing several "personal" book titles out of 155 boxes of research materials as primary evidence of non-exclusive use. The taxpayer provided evidence of exclusive business use for each of the specified areas, including photographs and invoices of stored contents.

Deduction of proportionate costs for exclusive use of specific areas for business is authorized by 26 U.S.C. 280A.

"In the case of a taxpayer (other than an employee) who exclusively uses a portion of the dwelling unit on

a regular basis as his principal place of business ... an allocable portion of ordinary and necessary ... expenses paid ... in connection with such ... use will be allowed as a deduction "....*General Explanation of the Tax Reform Act of 1976*, Joint Committee on Taxation, Dec. 29, 1976, pp. 140-141.

Several cases have clarified the statutory wording:

"Exclusive use does not require a wall or other physical demarcation. A separate area of a room can qualify for exclusive use." *Weightman v. Comm.*, TC Memo 1981-301.

Office at Home, Employee Business Expense

The issues are whether the use of an office at home was *for the convenience of* the employer and whether statutory language requires the office at home to be the *principal place of business* or a focal point of activities for the petitioner.

Factors to be considered are the amount time at the home office, the importance of the business function, the

business necessity and the expense in establishing the home office. If the office at home performs important functions, with circumstances such as *limited space at the business*, the result is a legitimate business decision to perform functions at the residence, *Meiers v. Comm.*, 782 F2d 75, 86-1 USTC (1986), *Drucker v. Comm*, 715 F.2d 67 (2d Cir. 1983).

The focal point of activities is not significant. The home office is a practical necessity if sufficient space is not provided by the employer. Working space for research materials in the office at home *is* sufficient rationale for convenience to employer, *Weissman v. Comm.*, 751 F2d 512 (1984), 85-1 USTC.

The court did not address several issues stated in the stipulation, which were the original basis for Commissioner disallowance, including whether the office at home deductions may be applied to increase a Schedule C net loss for 1983, whether the calculation of residence basis is correct, and whether landscaping costs are depreciable.

Depreciation, master computer tape. The trial court disallowed all of the costs for software, as not ordinary and necessary, 26 U.S.C. 162. Thus, the court did not decide on investment tax credit for the tape. A master computer tape is tangible property qualifying for investment tax credit, and the basis of tangible tapes includes the cost of collecting the data, *Texas Instruments vs. U.S.*, 407 F. Supp 1326 (1977), affd. in relevant part, 551 F2d 599. The cost of production that is capitalized determines the basis of a master film; production cost need not be allocated between tangible and intangible elements, *Hanna Barbera v. U.S.*, 77-1 USTC (1977). Master sound tapes are tangible personal property, entitled to investment tax credit, *EMI v. U.S.*, 675 F2d 1068 (1982). Statutes and regulations on investment credit should be liberally construed, consistent with legislative purpose to increase investments, *Minot Federal S&L vs. U.S.*, 435 F2d 1368 (1970) 71-1 USTC.

Foreign Travel. Special rules of calculation of costs for foreign travel do not apply if the taxpayer is out of the U.S. for one week or less, 26 U.S.C. 274(c)(2)(A). Thus costs are counted in the same manner as travel within the U.S. Under U.S. travel rules, costs for transportation and lodging are deductible if the trip has a primary business purpose, as contrasted to a primary personal purpose. Determination of primary purpose depends on the specific facts and circumstances, Reg. 1.162-2(b). The costs for a spouse are deductible if the wife's presence served a bona fide business purpose, Reg. 1.162-2(c), *U.S. v. Disney* 413 F2d 83, affg. 267 F.Supp 1, *Bank of Stockton* TC Memo 1977-24.

Closed Year Adjustments. The issue is whether the Commissioner may change basis or tax credit carryforward for closed tax years. The Commissioner calculated depreciation for 1983 and tax credit carryforward based on disallowance of basis and tax credits as stated in closed tax years. Changes in

depreciation basis or tax credit carryforward for closed tax years are not allowed, under statute.

Research tax credit. The issue is the amount of tax credit for increasing research during 1983. All amounts spent were disallowed as not reasonable and necessary, 26 U.S.C 162. However, the existence of the copyrighted software is *prima facie* evidence of facts stated on the copyright certificate, 17 U.S.C 410(c), with the implied fact that expenses were necessary to produce the software. For 1983, there was a 25% tax credit for the increase in qualified research costs over the base period, 26 U.S.C. 41, 1981 Act section 221 (formerly numbered 26 U.S.C. 44F). Qualified in-house research expenses include supplies, which are defined as any tangible property other than land or depreciable property used in the conduct of qualified research, 26 U.S.C. 41(b)(2)(C). Computer software development costs, for developing new or significantly improved programs, are allowed, *General Explanation of the 1981 Act*, p. 124.

Carryforward of Research Tax Credit. The issue is the amount of Research Tax Credit carryforward. Statute prevents changes of basis or tax credits from closed tax years, *26 U.S.C. 6501, 1311, 1312.* The Tax Court lacks jurisdiction to redetermine tax characteristics for closed tax years, 26 USC 6214(b). The Commissioner disallowed $573.02 tax credit carryforward from research credit earned in 1980-82, which were closed tax years. The Ninth Circuit cited *Mennuto v. Commissioner*, 56 T.C. 910, 923 (1971), as authority that allowed recomputing closed year credits. However, this decision is not applicable to research credits, and is clearly contrary to statute. Under prior law, net operating loss (NOL) carryover could be adjusted for closed years, 26 USC 6501(m), repealed 8/23/88, P.L. 100-418. By statute, changes in a prior year credit carryover are allowed *only to correct errors*, such as double counting, 26 USC 1312(2),(4), or if the taxpayer has maintained

position inconsisent with an erroneous deduction, 26 USC 1311(b)(1).

Dependent care tax credit. The issue is whether medical and hospital care expenses for wife qualify for dependent care tax credit. The decision of the Ninth Circuit was based on an erroneous interpretation of fact and law. Medical costs claimed under section 21 are not limited by section 213, as clearly stated at 26 U.S.C 213(e).

Penalty under 26 U.S.C. 6653(b). No penalty is due because the taxpayers adequately disclosed facts and the taxpayers position is supported by substantial authority, 26 U.S.C 6653(b). In order to impose a penalty for negligence, the Commissioner has the ultimate burden of proving negligence by the preponderance of evidence, *Emmons v. Commissioner*, 92 TC 20 (1989).

The commissioner failed to provide the required evidence of negligence. Thus, the Commissioner failed to meet their burden of proof.

Costs. The taxpayers are entitled to compensation fo costs because they prevailed on the most significant issue whether the business operation was a hobby (Stipulation 58(a), 26 U.S.C 183, 26 U.S.C 7430. This was a new issue for which the Commissioner had the burden of proof, TC Rule 142(a). The court did not decide that the Commissioner had carried the burden of proof.

Calculation under Rule 155. There were clea calculation errors by the Commissioner which were no corrected by the Ninth Circuit. The Commissione admitted that $295 tax credit was earned during 1983, bu failed to included this amount in the calculation:

ITC Carryover, 1/1/83	$3,370.23
Plus, Credits earned in 1983	295.00
Less, Recapture, 1983	367.11
Total ITC for 1983 return	$3298.09

Applicable statute allows sales tax deductions, 2 164(a). The Commissioner failed to allow the sales ta

amounts for admitted amounts paid which were disallowed as business deductions, of $1,584.52.

The Commissioner calculated $1,250 gain on sale of a vehicle for $5,000. The correct calculation is $243.37 loss, per 26 U.S.C. 1001. The Ninth Circuit recognized the trial court's error, but adopted the Commissioners figure of $210 gain, in error.

Therefore, based on the discussion of facts and law, the following is evident:

1. the trial exhibited a *significant departure from fundamental standards of fairness and justice*, through premature oral opinion, precluding explanation of exhibits, preventing oral closing argument, and dispensing with briefs,

2. through approval of the trial court procedure and *clearly erroneous* conclusions of law, the Ninth Circuit decision conflicts with Supreme Court decisions and decisions of other circuits,

3. the Ninth Circuit decision raises significant questions of *federal tax law* and *federal trial procedure*.

CONCLUSION

For the reasons stated, this petition for writ of certiorari should be granted. If the taxpayer is correct regarding the critical issues, the matter should be remanded to the U.S. Tax Court for appropriate disposition based on the law, after a full development of the facts.

Respectfully submitted,

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April 12, 1991

APPENDIX A

OPINIONS AND DECISIONS

Memorandum Decision,
U.S. Court of Appeals, Ninth Circuit..... A-1

Bench Opinion, U.S. Tax Court..... A-29

Order and Decision, U.S. Tax Court A-35

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 89-70314

Tax Ct. No. 17667-87

RICHARD R. SYLVESTER; IRENE L. SYLVESTER,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

MEMORANDUM*

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

Appeal from a Decision of the
United States Tax Court

Argued October 5, 1990
Pasadena, California
Submission Deferred October 5, 1990
Resubmitted November 19, 1990
Filed January 14, 1991

Before: BEEZER and TROTT, Circuit Judges, and CROCKER, District Judge**

Appellants, Richard R. and Irene L. Sylvester (the Sylvesters), appeal *pro se* from the judgment of the United States Tax Court that their joint federal income tax return for 1983 was deficient in the amount of

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** The honorable M.D. Crocker, Senior United Stated District Judge for the Eastern District of California, sitting by designation.

$5,412.93. They also appeal the determination that they owe additional amounts under sec. 6653[1/] (for negligent underpayment) and sec. 6661 (for substantial understatement of tax liability). The Tax Court had jurisdiction under sec. 6213, 6214 & 7442. We have jurisdiction over this timely appeal under sec. 7482. We affirm in part and remand for recalculation of the Sylvesters' tax liability.

I

FACTUAL BACKGROUND

The Sylvesters were employed full-time throughout 1983. During the same period, they ran a home publishing business called Ph.D. Publishing. Sometime during 1983, Mr. Sylvester completed development of two

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1/ Unless otherwise indicated, all citations are to sections of the Internal Revenue Code of 1954 (26 U.S.C.) as amended and in effect as of 1983.

computer software programs, both of which were manufactured by Ph.D. Publishing.[2/]

The Sylvesters filed a joint return for 1983. On that return, they claimed $17,838 worth of deductible employee business expenses. As part of those expenses, Mr. Sylvester claimed deductions for maintaining an office at home for the benefit of his employer.

The Sylvesters also claimed that Ph.D. Publishing generated $3,044.77 in income, but $21,664.56 in deductible expenses, resulting in a net losses of over $18,000. Part of those deductions included trips to Iowa and Italy, depreciation on their residence and depreciation on a car. The Sylvesters claimed that all three of their cars were used 85% of the time for business. At a later point, they attempted to claim dependent care tax credit for Mrs. Sylvester's medical expenses.

2/ The programs are called "Financial Factors" and "Tax Planning, for the 1983 Tax Return."

The Commissioner disallowed a majority of the above deductions as well as others not contested on this appeal.3/ After an aborted attempt to settle and a stipulation, which eliminated a few disagreements, the case proceeded to trial in the Tax Court. The Tax Court rejected Mr. Sylvester's testimony regarding his business purposes as "inherently improbable and cynical," and adopted the Commissioner's determinations *in toto*. Later, the Tax Court rejected Sylvester's calculation of resulting tax liability and adopted the Commissioner's calculation, which fixed the liability of the Sylvesters at

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3/ The Sylvesters conceded that claiming depreciation and an investment tax credit for a Rolex watch was inappropriate. They also gave up their claim for capital losses resulting from the sale of a bicycle, a refrigerator, a table saw, an air compressor and a router-sander. In addition, the parties agreed that $430 of investment credit was properly recaptured under sec. 47.

$5,412.93 plus penalties. The Tax Court delivered its opinion from the bench. The court did not make specific findings with respect to many of the claims in dispute.

The Sylvesters argue that the Tax Court erred in upholding the following determinations by the Commissioner:

(1) that Mr. Sylvester is not entitled to the deductions he claimed for employee business expenses;

(2) that the deductions claimed for Mr. Sylvester's own business, but disallowed, are not "ordinary and necessary";

(3) that the Sylvesters used only two of their cars for business 25% of the time, not three of them 85% of the time;

(4) that the Sylvesters are not entitled to claim dependent care credit for Mrs. Sylvester's medical care;

(5) that the Sylvesters are liable for additions to tax for negligent underpayment and for substantial understatement of tax liability.

The Sylvesters also request that this court determine:

(6) whether the Tax Court's computation of liability under Tax Ct. R. 155 was clearly erroneous; and

(7) whether the Tax Court's exclusion of documents offered into evidence was clearly erroneous.[4/]

[4/] Some of the Sylvesters' arguments are groundless and do not merit discussion on appeal. Mr. Sylvester alleges that the I.R.S. refused to settle the case in an effort to deter Sylvester and others like him, and in the hope that Sylvester himself would publicize the result. Even if all his allegations are true, the refusal did not violate his first amendment right to free speech.

The Sylvesters, argument that they are entitled to costs on appeal and below because they substantially prevailed on most of the significant issues has no factual basis. The same is true of their argument that the Tax Court failed to provide due process of law. Finally, the argument that the Commissioner is precluded by the doctrine of res judicata from relitigating issues previously decided was not raised by the Sylvesters at trial. See *Pierce County Hotel Employees & Restaurant Employees*

II

BURDEN OF PROOF AND STANDARD OF REVIEW

The taxpayer bears the burden of proving the Commissioner's determinations are wrong. See Tax Ct. R. 142. The Commissioner bears the burden of proving new matters and increases in deficiency. *Id.*

Decisions of the Tax Court are reviewed on the same basis as decisions in civil bench trials in United States District Courts. *Mayors v. CIR*, 785 F.2d 757, 759 (9th Cir. 1986). Factual findings are reviewed under the "clearly erroneous" standard. *Id.* Conclusions of law are reviewed de novo. *Kelley v. CIR*, 877 F.2d 756, 757 (9th Cir. 1989). Mixed questions of law and fact are generally reviewed de novo. Mayors, 785 F.2d at 759; United

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Health Trust v. Elks Lodge, 827 F.2d 1324, 1329 (9th Cir. 1987) (issues not raised at trial are outside scope of review).

States v. McConney, 728 F.2d 1195, 1199-1204 (9th Cir.), cert. denied, 469 U.S. 824 (1984).

The Tax Court's affirmance of the penalties for negligent or intentional disregard of rules and regulations is a factual finding reviewed for clear error. *Baxter v. CIR*, 816 F.2d 493, 496 (9th Cir. 1987).

Evidentiary rulings are reviewed for abuse of discretion and will not be reversed absent same prejudice. *Roberts v. College of the Desert*, 870 F.2d 1411, 1418 (9th Cir. 1988).

III

THE DEDUCTIONS

A. Employee Business Expenses

Sylvester claimed over twenty-one thousand dollars worth of deductions related to his employment. Deductions under sec. 162, for business expenses such as meals, travel, telephone use and publications, totaled $3,710. Sylvester also deducted a portion of expenses related to his residence, under sec. 280A, because he

claimed to use a portion of his residence as workspace for the convenience of his employer. These expenses consisted of a portion of residence depreciation ($5,530), a portion of residence interest expense totaling $11,127 and a portion of maintenance and other residence expenses totaling $1,066.

An expense is not deductible under sec. 162 if the taxpayer could have sought reimbursement from his employer but failed to do so. *Orvis v. CIR*, 788 F.2d 1406, 1408 (9th Cir. 1986). Expenses related to business use of the home by an employee are not deductible unless the use is for the convenience of the employer and exclusively for business. *See* sec. 280A. Managers from General Dynamics and Northrop, Mr. Sylvester's employers, testified at trial that employee business expenses were reimbursed by the employer. Those managers also testified that the companies provided all necessary work materials and that employees were expected to work at the office, not at their homes. The Tax Court rejected Mr. Sylvester's assertion that the nature of his particular responsibilities and insufficient

office space required that he store materials at home. The court also concluded that the space was not used exclusively for business (see discussion below). On these alternative bases, the court upheld the disallowance of all the deductions claimed for employee business expenses. The resulting increase to income totaled $12,308.[5/] The Tax Court's conclusion depends on the weight it gave to the conflicting testimony. Because the court's factual findings -- especially those involving credibility -- should not be disturbed unless they are clearly erroneous, we affirm the Tax Court's conclusion.

B. Deductions Related to the Home Publishing Business

5/ The remaining amount ($5,530 in depreciation) was not added to income in this part of the deficiency because all adjustments to depreciation were treated separately. In contrast, the interest expense was added to income here, shifted over to Schedule A, and then subtracted from income.

Sylvester also deducted expenses related to his home publishing business. Sylvester calculated these expenses based on his claim that he used 40% of his home on a regular basis, exclusively for this business. *See* sec. 280A. The expenses consisted of: $749 in residence interest expenses and $72 in utilities and maintenance. An additional deduction for residence depreciation ($9,323) will be ignored for the moment because depreciation was treated separately. Automotive expenses ($6,760) and operating expenses ($2,803) also were discussed separately.[6/] The Commissioner argued that only one room in the house (7% of the square footage) was used for business. The Commissioner further argued that expenses allocable to this portion of the residence, even if allowable under sec.290A(c)(1), should be disallowed under sec. 28OA(c)(5) to the extent they generate a loss. See Scott v. CIR, 84 T.C. 683, 688-92 (1985) (interpreting

6/ Deductions based on telephone expenses ($530) and interest on other loans ($1,548) apparently were allowed by the Commissioner and are not disputed here.

proposed regulation 1.280A-(2)(i)(2)(ii)). The Tax Court never reached these issues, because, as noted above, it concluded that the home office was not devoted exclusively to business use, as required by sec. 280A. This conclusion was based on (1) an examination of the contents of Sylvester's home office library, which persuaded the court that the collection was merely Sylvester's personal library, and (2) the Sylvesters' attempt to depreciate vacuum cleaner bags, a lawn mower and landscaping costs, which the court called "patently personal items." The Tax Court was particularly impressed by the following titles in Sylvester's library: "Persian Poems," "Family Law Symposium," "Collector Cars," and "Photography." Sylvester testified that all his books and periodicals were useful in his publishing business because of their varied styles of binding, advertising and writing.

Although Mr. Sylvester's explanation for the apparently personal library items is plausible, it was not clearly erroneous for the Tax Court to give it no weight. The court considered his testimony and conduct as a

whole in concluding that he was not a credible witness. In rejecting Sylvester's testimony, the court described it as "inherently improbable and cynical."

The determination, under sec. 280A of "exclusive use" should be reviewed for clear error. That determination is similar to the determination of "principal place of business," which is reviewed for clear error. *See Pomerantz v. CIR*, 867 F.2d 495, 497 (9th Cir. 1988) ("[W]e find that the Tax Court's determination of principal place of business [under sec 280A(c)(1)(a)] is essentially factual and subject to the clearly erroneous standard."). Even under the de novo standard, however, the Tax Court's application of the law to these facts was correct. Mr. Sylvester did not carry his burden of proving he was entitled to home office deductions under sec. 280A.

C. Interest Expense

The Commissioner allowed interest expense attributable to the residence to be deducted on Schedule A. *See* n. 4, supra.

D. Depreciation[7/]

1. Residence

Sylvester deducted 40% of the depreciation on his residence, including amounts spent for capital repairs and landscaping. ($3,255 on the residence, $2,316 on fixtures, $332 on landscaping.) Because his claim that a portion of the residence is a business asset was properly rejected, the disallowance of these deductions is affirmed.

2. Cars

The Sylvesters claimed they used three cars for business 85% of the time. The only evidence offered by the Sylvesters was their reconstruction of "typical" business trips. The Commissioner allowed the Sylvesters

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7/ The Sylvesters do not contest the disallowance of a $933 depreciation deduction for a Rolex watch.

to claim depreciation on two of the cars based on 25
business use. The Commissioner used the same figure
25% to adjust automobile expenses and gain on the sa
of the Sylvesters' Volvo. The Sylvesters argue that th
cannot be required to keep daily logs of their automoti
use in order to prove business purpose. See 1985-2 C
359, 361 (excerpt of H.R. Conf. Rep. No. 67, 99th Con
1st Sess. 6-11 (1985)). That does not mean, however, th
their testimony and "reconstruction" of business milea
must be accepted as conclusive proof of busine
purpose. The Sylvester's testimony was discredited
trial. The "reconstruction" was of limited probative valu
The Tax Court's conclusion that the Sylvesters failed
carry the burden of proof on the issue of the proporti
of business use attributable to the automobiles
affirmed.

3. Computer Tape

The Sylvesters claimed to market computer softwa
They claimed expenses totaling over eleven thousa

dollars related to the development of computer software. These amounts break down as follows:

Books, Periodicals	$31
Travel, air fare, hotels	$3,143
Equipment	$329
Conferences	$3,387
Supplies, research	$2,258
Supplies, development	$2,567
TOTAL	$11,715

Based on these expenses, the Sylvesters claimed a $1,147 investment tax credit and a $1,089 depreciation deduction.

The Tax Court never decided whether the Sylvesters were engaged in the software business. The court also never decided whether expenses incurred in producing a piece of software are deductible as capital expenditures or qualify for investment tax credit. *Cf. EMI North Am. Holdings, v. United States*, 675 F.2d 1068, 1069 (9th Cir. 1982) (per curiam) (capital expenditures incurred in producing master sound tapes qualify for investment tax credit). Instead, the court determined that most of the

expenses were personal in nature. The court agreed wit the Commissioner, who disallowed all of thes deductions, because "it is not clear how the documen presented relate to a computer tape. Most of th expenses appear to be personal."

The Sylvesters claimed their trip with their daughte to Italy was motivated by the desire to assess "potentia customer needs and market demand for deskto computer software," and to "obtain photographs for use i future publications ...." At the trial, over five years afte the journey, Mr. Sylvester admitted that he had yet to us any of the photographs in his publishing.

The Tax Court upheld the Commissioner determination that the travel expenses were no deductible. The court also agreed with the Commissione that the Sylvesters, alleged "business conferences consisting of 174 meals during the year (includin evidence of two or three meals in a single day) wer nothing more than personal meals. The court also hear evidence relating to periodicals that the Commissione argued were personal, for example, National Geographi

The court set forth no specific findings of fact or conclusions of law with respect to the categories of "Supplies, research" or "Supplies, development." The Commissioner, however, conceded that $261 and $157 worth of expenses were substantiated under these categories. In adopting the Commissioner's determinations, the Tax Court implicitly rejected the contention that these were ordinary and necessary business expense under sec. 162. The Sylvesters offered no evidence aside from a general description of their business activities to prove the relationship between their expenditures and their publishing business. We affirm the disallowance of expenses related to the computer tape.

E. Schedule C Operating Expenses

The Sylvesters claimed $4,332 in deductible expenses related to their home business. The Commissioner disallowed $1,515 worth of deductions because the substantiation took the form of a "reconstruction" of payments, with no receipts. The Commissioner divided

the remaining items (totaling $2,816) into deductible an nondeductible groups, depending on the nature of th item. For example, the Commissioner allowed $32 related to furniture and electronic equipment, bu disallowed $159 related to kitchenware and coffe supplies. The Tax Court had available to it evidenc regarding the general nature of the expenses, the overal circumstances and the alleged business purposes. Th Sylvesters suggest that they carried their burden in fron of the Tax Court. Because the determination depends s much on the weight given to Mr. Sylvester's testimony however, we affirm the Tax Court.

F. Investment Tax Credits[8/]

8/ The Sylvesters do not contest the disallowance of $491 investment tax credit for a Rolex watch. The partie stipulated that tax credit carryover from the previous yea produced a $3,003 tax credit.

The reduction in proportionate business use of the Sylvesters' Mercedes from 85% to 25% is discussed above. Based on the reduction, the Commissioner reduced the investment tax credit earned on the Mercedes from $681 to $200. The disallowance of a $1,147 credit related to computer software also is discussed above.

G. Research Credits

The Sylvesters claimed a $944 research credit under sec. 30 for supplies related to research. $573 was unused credit carried over from prior years. $371 was claimed for 1983 expenditures. The Sylvesters did not state which supply expenditures were related to the credit. The supply expenses accepted as established by the Commissioner totaled $418. ($261 for "research" and $157 for "development".) Research credit is determined by multiplying the increase in research expenses over the "base period" year by 25%. *See* sec. 30(a). The amount of research expense substantiated by the Sylvesters ($418) resulted in no research credit for 1983.

The Commissioner also disallowed similar carryover credits earned in previous years. The Sylvesters argument that the Commissioner cannot disallow credits earned in a closed year is without merit. *See Mennuto v. CIR*, 56 T.C. 910, 923 (1971) (Commissioner can recompute unused credit carryover from closed year to determine tax due in open year).

H. Dependent Care

Expenses incurred for dependent care, when that care allows the taxpayer to be gainfully employed, generate a tax credit under sec. 44A (Since renumbered as sec. 21). The Commissioner allowed a tax credit under this section equal to 20% of the substantiated costs related to care of the Sylvesters' children.

The Sylvesters claim that Mrs. Sylvester's medical expenses increase the credit under this section. A spouse qualifies as a dependent under this section if that spouse is "physically or mentally incapable" of caring for him or herself. sec. 44A(c)(1)(C). There is no evidence in the record that Mrs. Sylvester was physically or mentally

incapable of caring for herself. The Sylvesters argue that Mrs. Sylvester was unable to provide her own medical care. That fact is irrelevant. The deductibility of medical expenses is governed (and limited) by sec. 213. *See Id.* (medical expenses are deductible to the extent they exceed 7.5% of adjusted gross income). The Tax Court and Commissioner correctly disallowed this attempt to evade the limitations in sec. 213.

IV

THE CALCULATIONS

A. Automobile Expenses

The Commissioner reduced deductible automobile expenses by reducing the percentage of business use, as noted above. The Commissioner stipulated that the Mercedes and Volvo were used for business 25% of the time and reduced deductible auto expenses by $6,306, accordingly. The Sylvesters have not pointed to any clear error in this regard.

B. Sale of Automobile

The Commissioner admits that the gain on the sale of the Volvo was erroneously calculated as $1,250 rather than $210, the amount determined in the Notice of Deficiency and the stipulation. Accordingly, we remand for a recalculation of the Sylvesters' resulting tax liability, using the correct figure of $210.

V

THE ADDITIONS TO TAX

The Commissioner imposed additional tax under sec. 6653 (for negligent or intentional underpayment) and sec 6661 (for substantial understatement of tax liability). In light of Mr. Sylvesters advanced training (including a law degree) and experience (including publishing a book called "Strategic Planning: Tax Minimization and Investment Strategy," and in light of the large number of deductions that were clearly not allowable under the Tax Code, we affirm the additions under sec. 6653. Unless

recalculation reveals a tax liability of under $5,000, we also affirm the addition under sec. 6661.

VI

THE EVIDENTIARY RULINGS

The Sylvesters argue the Tax Court committed reversible error by excluding exhibits offered into evidence. At trial, Mr. Sylvester offered into evidence a computer listing of the library holdings of his employer, Northrop. The Tax Court sustained the objection of the I.R.S. attorney, Michael Noble, that the document was not authenticated by the testimony of the librarian who produced it.

Mr. Sylvester also tried to introduce what he called "impeachment evidence," consisting of correspondence between himself and Noble to show that Noble planned to settle most of the case and then changed his mind. The Tax Court sustained an objection that the material was irrelevant.

The Sylvesters have not demonstrated that the Tax Court abused its discretion in excluding this evidence, nor have they demonstrated any prejudice. *See Roberts v. College of the Desert*, 870 F.2d 1411, 1418 (9th Cir. 1988).

CONCLUSION

The case is REMANDED for recalculation of the Sylvesters' tax liability consistent with this opinion. In all other respects, however, the judgment of the Tax Court is AFFIRMED.

U.S. TAX COURT

Bench opinion by Judge Mary Ann Cohen

Docket No. 17667-89

p. 119

March 15, 1989

THE COURT: The Court has decided to render an oral opinion and the following represents the Court's oral opinion.

Respondent determined a deficiency of $6,144 in Petitioner's Federal Income Taxes for 1983 and additions to tax for negligence or intentional disregard of rules and regulations under Section 6653(a) and for substantial understatement of tax under Section 6661.

At this point it appears that the final deficiency may be less than $5,000 and if that's the case, the Section 6661 addition to tax will no longer be in issue.

However, if it is, then it will be bound by the comments that I make in the balance of my opinion.

The deficiency resulted from a disallowance of certain deductions and credits claimed by Petitioners.

Petitioners, therefore, have the burden of proving that they are entitled to those deductions and credits.

The satisfaction of that burden in this case depends on our accepting Petitioner's uncorroborated testimony. Petitioner has presented a series of non-persuasive, exaggerated and incredible claims that

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various items patently personal and otherwise nondeductible, constituted deductible expenses.

For example, he claims the expense of family trips to Amana, Iowa and Rome, Italy. The cost of those trips is so disproportionate to the alleged business purpose of the trips, that Petitioner's testimony about that purpose is not credible. Particularly the trip to Rome for Petitioner, both Petitioners and their daughter, is not reasonably related to the alleged computer software business as that business has been described by Petitioner.

Also he claims that medical expenses are deductible as the cost of dependent care are a blatant attempt to circumvent the limitations of Section 213 of the Internal Revenue Code.

Over $3,300 in meals expense have not been shown to be business related, as the requirements of the law for deductibility exist, and after examining the dates, the amounts and the locations, including claims of apparently two to three meals on the same dates and 174 meals in a one-year period, the Court concludes that the meals expenses are clearly personal.

With respect to the office in the home, that to some extent is claimed to have been to store research materials for use in Petitioner Richard Sylvester's employment, there are several reasons why these are not

page 121

deductible.

First, from a review of the titles ranging from "Persian Poems" to "Family Law Symposium," "Collector Cars," "Photography, "Toastmaster Guide," and "Language Guides," the Court is not persuaded that the items are anything more than Petitioner's personal library.

Thus the space is not exclusively used for business purpose. It's not even contested that the space in the

residence is not the principal place of Petitioner's employment. And the evidence refutes the claim that it is for the convenience of the employer.

Moreover, our conclusion that Petitioner's expenses relating to the home are not business related is supported by the items claimed in Exhibit 29-AC, which are patently personal items.

Overall, Petitioner's testimony is inherently improbable and cynical, and we are not required to and do not accept it as true.

Therefore the evidence is insufficient to satisfy Petitioner's burden of proof to the extent that Respondent has not accepted the substantiation and conceded the deductibility of the various items.

With respect to the additions to tax for negligence, Petitioner also bears the burden of proof. Some of the deductions that make up the deficiency have now

been conceded. Those items, such as (1) the claim of depreciation on a Rolex watch, which like any other item of apparel, suitable for daily use, is not deductible, and

(2) the claims of losses on sale of a bicycle, refrigerator and power tool are frivolous on their face. The other deductions have not been shown to be reasonable and Petitioner has failed to negate the addition to tax for negligence.

Therefore, the additions to tax under Section 6653(a) will be sustained. I want to comment further that during the course of these proceedings, Petitioner filed numerous nonmeritorious motions that served only to increase the cost of this proceeding to Respondent and to the Court. The Court concludes that Petitioners, both of whom claimed to have advanced degrees and business knowledge, should have known better and that they've used this proceeding to harass Respondent in an attempt to settle claims that they were not entitled to.

If this case or a similar case were to come before the Court again, Petitioner would be seriously risking imposition of damages under Section 6673 of the Internal Revenue Code.

In view of Respondent's concessions, decision will be entered under Rule 155.

That concludes the Court's opinion and we're adjourned until three o'clock.

UNITED STATES TAX COURT

WASHINGTON, D.C. 20217

Docket No. 17667-87

RICHARD R. SYLVESTER AND

IRENE L. SYLVESTER

Petitioner,

V.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ORDER AND DECISION

This case was tried in Los Angeles, California, on March 15, 1989. At the conclusion of the evidence, the Court rendered an oral opinion pursuant to Rule 152, Tax Court Rules of Practice and Procedure. That opinion was served on the parties on April 26, 1989, and directed that decision be entered in accordance with

Rule 155, Tax Court Rules of Practice and Procedure. We found that petitioners were not entitled to any deductions or credits not conceded by respondent and that petitioners were liable for additions to tax as determined by respondent. On May 19, 1989, petitioners filed a Motion for Litigation Costs and Administrative Costs, which was denied by the Court.

Respondent's Computation for Entry of Decision and petitioners' Computation of Tax Due under Rule 155 were filed June 5, 1989. Petitioners' Answer to Respondent's Computation for Entry of Decision was filed June 8, 1989. Respondent's Notice of Objection to Petitioners' Rule 155 Computation was filed July 11, 1989, pursuant to granting of respondent's Motion to File Out of Time a Notice of Objection and Alternative Rule 155 Computation.

Petitioners' computation includes adjustments not conceded by respondent or determined by the Court and relating to years not in issue in this case. Petitioners' objections to respondent's computation contain erroneous assertions about the burden of proof.

Petitioners bear the burden of proof as to all disallowed items and as to the additions to tax in issue, and petitioners have failed to satisfy that burden as to items not conceded by respondent. Certain portions of petitioners' computation and petitioners' objections are unintelligible. Upon due consideration and for cause, it is hereby

ORDERED: That the Court adopts respondent's computation for entry of decision. It is further

ORDERED and DECIDED: That there is a deficiency in income tax due from the petitioners for the taxable year 1983 in the amount of $5,412.93.

That there are additions to tax under section 6653(a)(1), I.R.C. as amended, in the amount of $270.65, under section 6653(a)(2) in an amount equal to 50 percent of the interest due on $5,412.93, and under section 6661 in the amount of $1,353.23. It is further

ORDERED and DECIDED: That there are no litigation costs awarded in this matter.

(Signed)

Mary Ann Cohen

Judge

Entered: July 14, 1989

APPENDIX B

AUTHORITIES*

Constitutional Provisions B-3

Statutes B-4

Regulations B-29

Other Authorities B-32

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* *The pertinent portions of the text are quoted verbatim.* The boldface headings are for finding purposes and may differ from the longer code headings. For certain portions as noted, italics are added for emphasis.

CONSTITUTIONAL PROVISIONS

"Congress shall make no law ... abridging the freedom of speech or of the press...." U.S. Constitution, Amendment I.

"No person shall be ... deprived of ... property, without due process of law; nor shall private property be taken for public use, without just compensation." U.S. Constitution, Amendment V.

STATUTES

Effect of Copyright certificate, 17 U.S.C. 410

(c) In any judicial proceedings the certificate of a registration made before or within five years after first publication of the work shall constitute prima facie evidence of the validity of the copyright and of the facts stated in the certificate. The evidentiary weight to be accorded the certificate ... thereafter shall be within the discretion of the court.

Dependent Care Tax Credit, 26 U.S.C 21

(formerly sec. 44)

(a) Allowance of Credit

(1) In General

In the case of an individual who maintains a household which includes as a member one or more qualifying individuals ... there shall be allowed as a credit against the tax imposed ... an amount equal to the applicable

percentage of the employment-related expenses ... paid ... during the taxable year.

* * *

(b) Definitions of qualifying individual and employment related expenses

For purposes of this section --

(1) Qualifying Individual

The term "qualifying individual" means-

(A) a dependent of the taxpayer who is under the age of 13...

(C) the spouse of the taxpayer, if he is physically or mentally incapable of caring for himself....

(2) Employment-related expenses

(A) In general

The term "employment-related expenses" means amounts paid for the following expenses, but only if the expenses are incurred to enable the taxpayer to be gainfully employed ...

(i) expenses for household services, and

(ii) expenses for the care of a qualifying individual....

(B) Exception

Employment-related expenses ... which are incurred for services outside the taxpayer's household shall be taken into account only if incurred for the care of --

(i) a qualifying individual described in paragraph (1)(A), or

(ii) a qualifying individual (not described in paragraph (1)(A)) who regularly spends at least 8 hours each day in the taxpayer's household...

Business Tax Credit, 26 U.S.C. 38

(a) Allowance of credit

There shall be allowed as a credit against the tax imposed ... an amount equal to the sum of --

(1) the business credit carryforwards ...

(2) the amount of the current year business credit, plus

(3) the business credit carrybacks ...

(b) Current year business credit

For purposes of this subpart, the amount of the current year business credit is the sum of the following credits ...

(1) the investment credit determined under section 46(a) ...

(4) the research credit determined under section 41(a) ....

(d) ordering rules

For purposes of sections 46(f), 47(a), 196(a), and any other provision of this title where it is necessary to ascertain the extent to which the credits ... are to be used in any taxable year or as a carryback or carryforward --

(1) In general

The order in which such credits are used shall be determined on the basis of the order in which they are listed in subsection (b) as of the close of the taxable year in which the credit is used....

Research credit, 26 U.S.C. 41 (formerly sec. 44F)

(a) General rule[1]

For purposes of section 38, the research credit ... shall be ...

(1) 25 percent of the excess (if any) of --

(A) the qualified research expenses for the taxable year, over

(B) the base period research expenses,

and

(2) 25 percent of the basic research payments determined under subsection (e)(1)(A).

(2) In-house research expenses

(A) In general

---

[1] The 1986 Act, Pub. L. 99-514 sec. 231(c)(a) amended subsection (a) to change 25% to 20%, applicable after Dec. 31, 1985.

The term "in-house research expenses" means -- ...

(ii) any amount paid or incurred for supplies used in the conduct of qualified research,...

(C) Supplies

The term "supplies" means any tangible property other than --

(i) land or improvements to land, and

(ii) property of a character subject to the allowance for depreciation.

(d) Qualified research defined

For purposes of this section --

(1) In general

The term "qualified research" means research --

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information --

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3)....

(2) Tests to be applied separately to each business component

....

(B) Business component defined

The term "business component" means any product, process, computer software, technique, formula or invention which is to be --

(i) held for sale, lease, or license

(ii) used by the taxpayer in a trade or business of the taxpayer....

Business expenses, 26 U.S.C. 162

(a) In general

There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business ....

Research expenses, 26 U.S.C 174

(a) Treatment as expenses

(1) In general

A taxpayer may treat research or experimental expenditures which are paid or incurred by him during the taxable years ... as expenses which are not chargeable to capital account. The expenditures so treated shall be allowed as a deduction....

(b) Amortization of certain research and experimental expenditures

(1) In general

At the election of the taxpayer, ... research or experimental expenditures ... may be treated as deferred expenses. In computing taxable income, such deferred

expenses shall be allowed as a deduction ratably over such period as not less than 60 months as may be selected by the taxpayer ....

Capital Loss on personal property held for investment, 28 U.S.C. 165

(a) General Rule

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * *

(c) Limitation on losses of individual

In the case of an individual, the deduction ... shall be limited to --

* * *

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business ...

Activities Not for Profit , U.S.C. 183

(a) General Rule

In the case of an activity engaged in by an individual ... not ... for profit, no deduction attributable to such activity shall be allowed ... except as provided in this section.

(b) ... there shall be allowed --

(1) the deductions which would be allowable ... without regard to whether or not such activity is engaged in for profit, and

(2) a deduction equal to the amount ... which would be allowable ... if such activity were ... for profit, but only to the extent that the gross income derived from such activity ... exceeds the deductions allowable by reason of paragraph (1).

Expenses for production of Income, 26 U.S.C 212

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year --

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

Medical expense, 26 U.S.C 213

(a) Allowance of deduction

There shall be allowed as a deduction the expenses paid during the taxable year, not compensated by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependant... to the extent that such expenses exceed 7.5 percent of the adjusted gross income.

* * *

(e) Exclusion of amounts allowed for care of certain dependents

Any expense allowed as a credit under section 21 shall not be treated as an expense paid for medical care.

Amendments to Section 213

1986-- Subsect. (a) Pub. L. 99-514 substituted "7.5 percent" for "5 percent."

1984 -- Subsec. (e), Pub. L. 98-369, sect. 474(r)(9), substituted "section 21" for "section 44A."

Personal expenses, 26 U.S.C 262

(a) General Rule

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

Travel and entertainment expenses, 26 U.S.C 274

(a) Entertainment, amusement, or recreation

(1) In general

No deduction otherwise allowable under this chapter shall be allowed for any item --

(A) Activity

With respect to ... entertainment, amusement, or recreation, unless the taxpayer establishes that the

item was directly related to ... or associated with, the active conduct of the taxpayer's trade or business.

* * *

(c) Certain foreign Travel

(1) In general

In the case of any individual who travels outside the United States ... no deduction shall be allowed ... which ... is not allocable to such trade or business.

(2) Exception

Paragraph (1) shall not apply to the expenses of any travel outside the United States ... if

(A) such travel does not exceed one week

(B) such portion of the time of travel ... which is not attributable to the pursuit of the taxpayer's trade or business ... is less than 25 percent of the total time on such travel.

(3) Domestic travel excluded

For purposes of this subsection, travel outside the United States does not include any travel from one point in the United States to another point in the United States.

(d) Substantiation required

No deduction or credit shall be allowed ... unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement (A) the amount of such expense or other item (B) the time and place of the travel, entertainment, amusement, recreation...(C) the business purpose of the expense or other item, and (D) the business relationship to the taxpayer of the persons ...

(e) Specific exemptions to application of subsection (a)

Subsection (a) shall not apply to --

* * *

(5) Employees, stockholder, etc. business meetings

Expenses incurred by a taxpayer which are directly related to business meetings of his employees, stockholders, agents, or directors.

* * *

(k) Business meals

(1) In general

No deduction shall be allowed under this chapter for the expense of any food or beverages unless --

(A) such expense is not lavish or extravagant under the circumstances, and

(B) the taxpayer ... is present at the furnishing of such food or beverages.

Business use of Home, 26 U.S.C. 280A

(a) General rule

Except as otherwise provided in this section ... no deduction otherwise allowable ... shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

(b) Exception for interest, taxes, casualty losses, etc.

Subsection (a) shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business ...

(c) Exceptions for certain ... use ...

(1) Certain business use

Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis--

(A) the principal place of business for any trade or business of the taxpayer.

* * *

(2) Certain storage use

Subsection (a) shall not apply to any item to the extent such item is allocable to space within the dwelling unit which is used on a regular basis as a storage unit for the inventory of the taxpayer ... if the dwelling unit is the sole fixed location of such trade or business.

Self-Employed Individual as Employee, 26 U.S.C. 401 (c)

(c) Definitions and rules relating to self-employed individuals and owner-employees

For purposes of this section --

(1) Self-employed individual treated as employee

(A) In general

The term "employee" includes ... an individual who is a self-employed individual for such taxable year.

Determination of gain or loss, 26 U.S.C. 1001

(a) Computation of gain or loss

The gain from the sale ... of property shall be the excess of the amount realized ... over the adjusted basis ... and the loss shall be the excess of the adjusted basis ... over the amount realized.

Adjusted basis, 26 U.S.C. 1011

The adjusted basis for determining the gain or loss ... shall be the basis ... adjusted as provided in section 1016.

Basis of property -- cost, 26 U.S.C. 1012

The basis shall be the cost of such property.

Adjustments to basis, 26 U.S.C. 1016

(a) General rule

Property adjustment in respect of the property shall in all cases be made --

(1) for expenditures, receipts, losses, or other items, properly chargeable to capital accounts ...

(2) ... for ... amortization, and depletion, to the extent ... allowed as deductions in computing taxable income ...

Changes for closed years, 26 U.S.C. 1311

Correction of error

(a) General rule

If a determination ... is described in ... section 1312 and , on the date of the determination, correction of the effect of the error ... in prevented by the operation of any law ... then the effect of the error shall be corrected ... in the manner specified in section 1314.

(b) conditions necessary for adjustment

(1) Maintenance of an inconsistent position ...

(2) Correction not barred at time of erroneous action ....

Circumstances of adjustment, 26 U.S.C. 1312

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

(1) Double inclusion of an item of gross income ...

(2) Double allowance of a deduction or credit ...

(3) Double exclusion of an item of gross income ...

(4) Double disallowance of a deduction or credit ...

Jurisdiction of the Tax Court, 26 U.S.C. 6214

* * *

(b) The Tax Court in redetermining a deficiency of income tax ... shall have no jurisdiction to determine whether or not the tax for any other year ... has been overpaid or underpaid....

Three-year Limit on Assessment, 26 U.S.C. 6501

(a) General rule

Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed ... and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

Penalty for negligence, 26 U.S.C. 6653

(a) Negligence

(1) In general

If any part of any underpayment ... of tax required to be shown on a return is due to negligence (or disregard of the rules or regulations), there shall be added to the tax an amount equal to 5 percent of the underpayment ....

(3) Negligence

For the purposes of this subsection, the term "negligence" includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term "disregard" includes any careless, reckless, or intentional disregard.

Penalty for Substantial Understatement, 26 U.S.C. 6661

(a) Addition to Tax

If there is a substantial understatement of income tax ... there shall be added to the tax an amount equal to 25 percent of the amount of any underpayment attributable to such understatement

(b) Definition ...

* * *

(2) Understatement ...

(A) * * *

(B) Reduction for understatement due to position of taxpayer ...

The amount of the understatement ... shall be reduced by that portion of the understatement which is attributable to -

(i) the tax treatment of any item by the taxpayer if there is or was *substantial authority* for such treatment, or

(ii) any item with respect to which the relevant facts affecting the item's tax treatment are *adequately disclosed* in the return or in a statement attached to the return. ... (emphasis added).

Award of costs, 26 U.S.C. 7430

(a) In General

In any administrative or court proceeding which is brought by or against the United States in connection with the determination ... of any tax ... under this title, the prevailing party may be awarded a judgment ... for

(1) reasonable administrative costs incurred...

(2) reasonable litigation costs incurred ...

* * *

(c) Definitions

For the purposes of this section --

(1) Reasonable litigation cost

The term "reasonable litigation costs" includes --

(A) reasonable court courts, and

(B) based on prevailing market rates for the kind or quality of services furnished ... (ii) the reasonable cost of any study, analysis, ... or project which is found by the court to be necessary for the preparation of the party's case ...

(4) Prevailing party

(a) In general

The term "prevailing party" means any party ... (other than the United States...)

(i) which established that the position of the United States ... was not substantially justified,

(ii) which --

(I) has substantially prevailed with respect to the amount in controversy, or

(II) has substantially prevailed with respect to the most significant issue or set of issues presented ....

Repeal of contemporaneous records for auto use, Public Law 99-44 (May 24, 1985)

Section 1. Repeal of contemporaneous recordkeeping requirements, etc.

(a) ... Subsection (d) of section 274 ... (relating to substantiation requirements for certain deductions and credits) is amended by striking out "adequate contemporaneous records" and inserting in lieu thereof "adequate records or by sufficient evidence corroborating the taxpayer's own statement"....(Published in 1985-2 C.B. p. 350).

REGULATIONS

Personal benefit exemption, 26 CFR 2.274-2

(b) Definitions

(1) Entertainment Defined.

(i) In general. ... The term "entertainment" does not include activities which, although satisfying personal, living, or family needs of an individual, are clearly not regarded as constituting entertainment, such as (a) *supper money provided by an employer to his employee working overtime* ... (c) an automobile used in the active conduct of trade or business even though used for routine personal purposes such as commuting to and from work. (emphasis added).

Quiet Business Meal Exception, 26 CFR 2.274-2(f)

(1) In general. The provisions ... (imposing limitations on deductions for entertainment expenses) are not applicable in the case of expenditures set forth in

subparagraph (2) of this paragraph. Such expenditures are deductible to the extent allowable ... under section 162 or 212 and the regulations thereunder.

(2) Exceptions. ...

(i) Business meals and similar expenditures-- (a) In general. Any expenditure for food or beverages furnished to an individual under circumstances of a type generally considered conducive to business discussion ... is not subject to the limitations on allowability of deductions provided for ... in this section. There is no requirement that business actually be discussed for this exception to apply.

(b) Surroundings. The surroundings in which the food or beverages are furnished must be such as would provide an atmosphere where there are no substantial distractions to discussion ... such as a floor show.

(c) Taxpayer's trade or business and relationship of persons entertained.

The taxpayer's ... business ... and the relationship of the persons to whom the food or beverages are served ... must be such as will reasonably indicate that the food or beverages were furnished for the primary purpose of furthering the ... business and did not primarily serve a social or personal purpose.

OTHER AUTHORITIES

Congressional Intent

General Explanation 1981 Act, p. 27.

In addition to providing a stimulus for additional saving, the marginal rate reductions will *encourage the expansion of many small business activities* by increasing the after-tax return to those activities. (emphasis added).

General Explanation 1981 Act, p. 120

The Congress believed that the provisions of the Act, which are designed to stimulate a higher rate of capital formation and increased productivity, appropriately include incentives for greater private activity in research by operating businesses.

General Explanation 1981 Act, p. 124

... For purposes of the new credit, the Congress intended that otherwise qualifying types of expenditures ... which are part of the *costs of ... research* for the development of new or significantly improved *computer software are to be eligible* for the credit .... (emphasis added).

Burden of Proof for new matters

U.S. Tax Court Rules, 142(a)

(a) General

The burden of proof shall be upon the petitioner, except as otherwise provided by statute or determined by the Court; and except that, in respect of any new matter ... it shall be upon the respondent.

Contemporaneous Auto logs prohibited

1985-2 CB p. 361

...the Treasury is *specifically prohibited* from requiring that taxpayers keep daily contemporaneous logs of their use of automobiles. Taxpayers are *not required*

to maintain trip-by-trip logs and records encompassing each element of the substantiation standards of section 274(d) to justify a deduction or credit ... (emphasis added)

Allocation of Cost, Rev. Rul 62-180, 1962-2 CB 54.

... Where a portion of a residence is devoted to business purposes on a regular basis , the portion of the depreciation and other costs incurred in maintaining the residence ... is a question of fact to be decided in each case. However, in making an allocation of expenses, it would ... be proper to compare the ... square feet of space devoted to a business purpose to the total ... square feet of the residence and apply the ratio ... Such methods of allocation are not the only methods which may be made. *Any other method which is reasonable under the circumstances will be acceptable.* (emphasis added).

General Explanation of the Tax Reform Act of 1976, Joint Committee on Taxation, Dec. 19, 1976, pp. 140-141

In the case of a taxpayer (*other than an employee*) who exclusively uses a portion of the dwelling unit on a regular basis as his *principal place of business* ... an allocable portion of ordinary and necessary ... expenses paid ... in connection with such ... use will be allowed as a deduction. ....(emphasis added.)